

# Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

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Refer Reply To:  
CC:PSI:B01 – PLR-154513-07  
Date:  
May 02, 2008

X =

Date 1 =

Date 2 =

Date 3 =

Trust 1 =

Trust 2 =

Dear :

This responds to a letter dated November 28, 2007, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code for an inadvertent termination of an S corporation election.

## Facts

X elected to be treated as an S corporation for federal tax purposes, effective Date 1. On Date 2, Trust 1 and Trust 2 became shareholders of X. The shareholders of X incorrectly believed that Trust 1 and Trust 2 were grantor trusts. However, Trust 1 and Trust 2 were ineligible shareholders of X. As a result, X's S corporation election terminated on Date 2. On or before Date 3, the terms of Trust 1 and Trust 2 were reformed to comply with the grantor trust provisions. In addition, Trust 1 and Trust 2

terminated and all of the shares held by Trust 1 and Trust 2 were transferred to eligible S corporation shareholders.

X represents that there was no intent to terminate X's S corporation election and that the transfer to ineligible shareholders Trust 1 and Trust 2 was not motivated by tax avoidance or retroactive tax planning.

X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(i) provides that, for purposes of section 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(f) provides, in relevant part, that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then,

notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 2 because Trust 1 and Trust 2 were ineligible shareholders. We further conclude, however, that the termination was an inadvertent termination within the meaning of section 1362(f). Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation on and after Date 2, unless X's S election is otherwise terminated under section 1362(d).

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

David R. Haglund

David R. Haglund  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: